

March 9, 1988

Mr. K--- C. B---  
Partner  
--- & ---  
XXX --- ---, Suite XXX  
---, CA XXXXX

I--- L--- F--- Corporation - SP UT XX XXXXXX  
Aircraft leased to common carriers - modifications and  
replacement parts

Dear Mr. B---:

In your January 25, 1988 letter to Mr. E. L. Sorensen, Jr., Senior Tax Counsel for the Board, which was referred to me for reply, you request certain rulings on behalf of your client, I--- L--- F--- Corporation, pursuant to Revenue and Taxation Code Section 6596 (reliance on written advice). The specific facts related to the transactions on which you request rulings are as follows:

“The taxpayer is engaged in the business of aircraft leasing. The subject aircraft are leased to common carriers; as that term is defined under Section 1621(a) of the California Administrative Code [Title 18]. These aircraft are utilized in varying degrees of interstate, intrastate, and foreign commerce, depending on the lessee/air carrier’s route systems and type of aircraft. In no case are the subject aircraft used exclusively in intrastate commerce within the state of California.

“The aircraft are newly constructed, and are acquired directly from the manufacturer, with delivery typically occurring at the manufacturer’s facility. The state of delivery will vary, depending on the aircraft manufacturer’s business location. Although the exact sequence of steps may vary slightly from case to case, the taxpayer will usually: 1) execute a commitment to purchase the aircraft and, 2) shortly thereafter execute a long-term lease arrangement with the common carrier – lessee. Delivery of the aircraft to the lessor is made at manufacturer’s facility, and actual possession of the aircraft is immediately transferred to the lessee, along with responsibility for insurance, maintenance, and operation of the subject aircraft.

“In certain instances, the aircraft will immediately be flown from the manufacturer’s location to another destination, to commence service in interstate commerce. In other cases, further modification of the aircraft may still be necessary, depending on the unique preferences of each lessee. For example, certain galley, seating or avionics modifications may still be necessary before the aircraft is ready for use in its intended role. These modifications may be made by

a vendor located near the aircraft manufacturer's plant or at another location. These vendors are located both within and outside the State of California.

"In another case, an aircraft lease may be executed and commence at the manufacturer's plant in Washington State. However, prior to the aircraft being placed in service, it may be flown to a 'mod shop' in California for finishing of galley or avionics packages.

"In either case, shortly after completion of this finishing work, the aircraft will be placed in service in interstate commerce by the lessee/air carrier.

"Pursuant to the terms of the lease arrangement, the taxpayer, as lessor, must reimburse the lessee for the costs it incurs in replacing certain time-sensitive equipment which is integral to the safe operation of the aircraft. This periodic maintenance is performed at a 'mod shop' located outside the State of California.

"The replacement parts are either purchased directly by the repair facility or by the lessee for delivery to the repair facility. In either case, the necessary maintenance is performed at that time, and the aircraft is immediately returned to service in interstate commerce, as before. Any modification made to leased aircraft which is beyond the maintenance described above is the responsibility of the lessee."

### Opinion

Only the Board itself may issue rulings; however, the Board's legal staff can give you our opinion on how tax applies to these transactions. I have quoted below the rulings you request, followed by our responses. Since we agree with your discussion and analysis of the applicable rules related to each of these transactions, with one qualification noted in our answer to issue no. 4 below, we need only restate and summarize what you have set out in your letter.

### Issue

"1. The purchase by ILFC of an aircraft from a California manufacturer, followed by the lease of that aircraft to a common carrier, is not subject to California sales or use tax."

"2. The purchase by ILFC of an aircraft from an out of state manufacturer, followed by the lease of that aircraft to a common carrier which, in the course of its initial use of the subject aircraft, brings that aircraft into California, is not subject to California sales or use tax."

Answer. We agree with your contention that these transactions are exempt from tax under Revenue and Taxation Code Section 6366.1(a). You write:

“Because the subject aircraft are leased to businesses which utilize them as common carriers, the taxpayer believes that RTC § 6366.1 is dispositive of issues 1 and 2. Under the provision of RTC § 6366.1, the initial purchase of the aircraft within California (i.e. from a California manufacturer) would be exempt from California Sales and Use Tax. Similarly, the purchase of an aircraft outside of California, followed by a lease to a common carrier which would regularly use that aircraft in revenue flights both inside and outside of California would, under § 6366.1, also be exempt from tax.”

Issue

“3. The tangible personal property associated with modifications made within California to the newly-acquired and leased aircraft, is not subject to sales or use tax.”

Answer. We agree with your contention that this transaction is likewise exempt from sales or use tax under Section 6366.1 and Regulation 1593(d). You write:

“Because the modifications in question (i.e. installation of passenger seats, galley facilities, avionics equipment, etc.) represent work which is essential to the aircraft’s ability to operate in its intended role (i.e. transportation of passengers as a common carrier) these modifications are essentially a continuance of the basic construction of the aircraft itself.”

Issue

“4. The tangible personal property associated with the periodic maintenance of the leased aircraft, performed outside California, is not subject to California use tax when the property is installed outside California and the leased aircraft returns to California in the course of resuming flights in its role as a common carrier.”

Answer. We agree with your contention that where integral replacement parts of the aircraft have been installed on the aircraft outside of California, and the aircraft is then flown into California, the taxpayer’s purchase of the replacement parts outside of California is not subject to use tax. You contend that this conclusion is supported by replacement parts of the aircraft have been installed on the aircraft outside of California, and the aircraft is then flown into California, the taxpayer’s purchase of the replacement parts outside of California is not subject to use tax. You contend that this conclusion is supported by Flying Tiger Line, Inc. v. State Board of Equalization, 157 Cal. App. 2d 85, and Pan American World Airways, Inc. v. State Board of Equalization, 131 Cal. App. 2d 638.

We note that the Pan American case dealt with the installation of integral parts outside this state on new aircraft, prior to the delivery of the aircraft in this state. These parts were thus not replacement parts, but rather were parts installed as a step in the manufacture of the aircraft. We do not think the Pan American case supports your contention.

The Flying Tiger Line case presents facts closer to the situation you present. The court held that use tax did not apply to ailerons purchased and installed out of state as replacement parts on used aircraft which were also purchased by Flying Tiger Line out of state. After the ailerons were installed, the aircraft were first flown into California. Although in the situation you present, the aircraft have already been used in California, we believe the replacement parts lose their identity as parts and become an integral part of the aircraft while the aircraft are outside the state, and use tax does not apply to the purchaser of the replacement parts. We note that under National Aircraft Leasing, Ltd. v. State Board of Equalization, 90 Cal. App. 3d 549, sales tax would apply to the sale of replacement parts for aircraft leased to common carriers, if those replacement parts were installed on the aircraft in this state.

If you have any further questions or comments about this letter, please feel free to contact me.

Sincerely,

John Abbott  
Tax Counsel

JA:jb